

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND
THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE
INFORMATION OF XHARIEP DISTRICT MUNICIPALITY FOR THE YEAR ENDED
30 JUNE 2009**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Xhariep District Municipality which comprise the balance sheet as at 30 June 2009, income statement and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Accumulated surplus / deficit

4. I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness, valuation and allocation of the accumulated surplus of R4 416 299 (2008: R2 817 064) as presented in the Balance Sheet. Included in the accumulated surplus is appropriations as disclosed in note 10 to the financial statements amounting to R1 345 077 of which R491 622 (2008: R6 451 028) sufficient appropriate audit evidence could not be obtained. These appropriations were in respect of the transactions to write off the suspense accounts. In the absence of supporting documents, alternative audit procedures could not be performed as there was no system of control, over suspense accounts and therefore no confirmation could be obtained that these prior period errors were accurate, completely adjusted and presented in the financial statements.

Income

5. Sufficient appropriate audit evidence could not be obtained to confirm the completeness, occurrence and accuracy of income amounting to R18 016 753 (2008: R14 747 026) as presented in the income statement due to the following:
 - (a) Registers for direct income received could not provide sufficient appropriate audit evidence in support of rental income amounting to R235 776 (2008: R255 214) as recorded in the income statement. Reconciliations were not prepared between the rental income according to the registers and the general ledger on a monthly basis; consequently I could not confirm the completeness of income disclosed.
 - (b) Included in interest and other income amounting to R1 257 890 as presented in the income statement of the prior year is an amount of R96 950 which could not be confirmed against appropriate audit evidence. In the absence of supporting documentation, the entity's records did not permit the application of alternative audit procedures to confirm accuracy and completeness thereof.
 - (c) Receipts amounting to R40 706 in the prior year could not be traced to a deposit slip or the bank statements. In the absence of supporting documentation and the lack of the reconciliation between the deposit slips and the bank statements, no reasonable alternative audit procedures could be performed.
 - (d) Included in income as presented in the income statement is an invoice relating to the prior year amounting to R24 596 that was erroneously recaptured in the general ledger in the current year resulting in overstatement of income and debtors.
 - (e) The applicable basis of accounting requires that when the conditions of the conditional grant are met, the expenditure incurred is transferred to expenditure in the income statement and the income equal to expenditure incurred during the financial year is recognised. The total amount of the grant in the prior year was recognised resulting income and expenditure in the prior year being overstated with an amount of R862 145 as the conditions of the grant was not fully met.

Fixed assets

6. The existence, completeness, rights of ownership, valuation and allocation of fixed assets as disclosed in note 3 to the annual financial statements amounting to R17 901 884 in the prior year could not be confirmed due detailed asset register containing information on the valuation, financing, physical condition and location of each asset as required by section 63(2)(c) of the MFMA was not maintained. A difference of R1 563 214 was identified between the fixed asset register and the amount according to the financial statements in the prior year. In the absence of updated fixed asset register, the entity's records did not permit the application of alternative audit procedures.

Cash on hand

7. The existence, valuation and completeness of cash on hand as disclosed in the balance sheet and note 7 to the annual financial statements amounting to R1 773 760 in the prior year could not be confirmed. The cash book balance amounting to R1 010 055 in the prior year bank reconciliation did not agree to the general ledger and the annual financial statements. The difference of R763 705 was identified between the bank reconciliation and the financial statements of which management could not provide the information and explanations I

considered necessary to confirm the accuracy of the balance as disclosed in the financial statements and I could not perform reasonable alternative audit procedures. Accordingly, I was unable to determine whether any adjustments might have been necessary to cash on hand as disclosed in the financial statements.

Provisions

8. A provision for leave amounting to R134 132 in the prior year as disclosed in the balance sheet and note 8 to the financial statements could not be confirmed due to supporting documentation for the calculation of leave provision which could be obtained. The entity's records did not permit the application of alternative procedures as management did not maintain adequate leave registers. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the existence, completeness, valuation and allocation of leave provision.

Expenditure

9. The occurrence and accuracy of expenditure as presented in the Income Statement to the value of R18 047 144 in the prior year could not be confirmed due to supporting documentation to the value of R792 322 that could not be provided by management. In the absence of supporting documentation, the entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might have been necessary to the amounts shown in the financial statements for expenditure.

Commitments

10. As disclosed in note 20 to the financial statements is a capital commitment amounting to R669 077. It was identified during the audit that this commitment relates to prior year; consequently commitments as disclosed were overstated by the same amount.

Irregular expenditure

11. As disclosed in note 23.1 to the financial statements, irregular expenditure for the prior year to the amount of R1 793 843 incurred as a result of expenditure incurred by the municipality which was contrary to the legislation. In the current year, irregular expenditure was identified during the audit amounting to R1 241 424 due to expenditure incurred by the municipality which was contrary to the legislation and was not disclosed in the note to the financial statements. This irregular expenditure was again not prevented or detected by the municipality's system of internal control.
12. I could not be provided with sufficient, appropriate audit evidence that management has properly identified, investigated and recorded all irregular expenditure transactions during the year under review. There were no satisfactory alternative audit procedures that I could perform to confirm the completeness of irregular expenditure as disclosed.

Unauthorised expenditure

13. As disclosed in note 23.2 to the financial statements, unauthorised expenditure to the amount of R554 110 (2008: R3 028 987) was incurred. Audit determined unauthorised expenditure as R2 316 674 and consequently unauthorised expenditure was not completely disclosed.

Disclaimer of opinion

14. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matter

I draw attention to the following matter on which I do not express a disclaimer of opinion:

Basis of accounting

15. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.1.

Other matters

I draw attention to the following matter(s) that relate(s) to my responsibilities in the audit of the financial statements:

Unaudited supplementary schedules

16. The supplementary information set out on pages XX to XX does not form part of the financial statements and are presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

Non-compliance with applicable legislation

Municipal Finance Management Act, 2003 (Act No. 56 of 2003)(MFMA)

17. The accounting officer did not table in the municipal council within 30 days after the end of each quarter, a consolidated report of all withdrawals or payments made in terms of section 11(4)(a) of the MFMA.
18. The municipal council did not consider approval of the budget at least 30 days before the start of the budget year as required by section 24(1) of the MFMA.
19. The mayor did not submit a report to the council on the implementation of the budget and the financial state of affairs of the municipality within 30 days of the end of each quarter as required by section 52(d) of the MFMA.
20. The mid-budget report was not submitted to the council by the 31st of January 2008 as required by section 54(1) of the MFMA.
21. Not all written employment contracts could be obtained as required by section 57(1)(a) of the MFMA.

22. Payments amounting to R234 935 were found not to be made within 30 days after receipt of the suppliers invoice which is in contravention with section 65(2)(e) of the MFMA.

Municipal Systems Act, 2000 (Act No. 32 of 2000)(MSA)

23. The performance agreement between the accounting officer and the executive mayor could not be obtained, therefore I could not confirm whether the requirements of section 57(1)(b) of the MSA were complied with.
24. Updated tariff policy could be obtained for the rental of the municipality's buildings as required by section 74 of the MSA.

Municipal Structures Act, 1998 (Act No. 117 of 1998)(MSA)

25. The municipal council did not meet quarterly as required by section 18(2) of the Municipal Structures Act.

Governance framework

26. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Internal control deficiencies

27. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
4	Accumulated surplus				1	
5	Income	7				
6	Fixed assets			3		
7	Cash on hand			3		
8	Provisions			3		
9	Expenditure				1	
10	Commitments	7				
11	Irregular expenditure					1

12	Unauthorised expenditure	5				
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Overall reflections on the governance framework based on internal control deficiencies

28. Amongst finance staff there was a general lack of understanding of the accounting framework. The municipality is experiencing difficulties in attracting officials with relevant skills and expertise in the accounting environment, consequently the positions in the finance section are filled by the interns. The municipality managed to address the matters that were raised in the prior year qualifications in the current year but did not manage to correct the matters retrospectively which resulted in the disclaimer of opinion. The issues that could not be resolved relates predominantly to legacy issues.
29. The chief financial officer did not sufficiently monitor the recording and reconciliation of the financial records as he was the only section 57 manager appointed by the municipality and was taking the responsibility of fulfilling the responsibilities of the vacant positions. The position of the Municipal manager was vacant since October 2006 and the position was only filled in May 2009. During this period, there was leadership instability as the incumbents were rotated on a frequent basis. The Chief Financial Officer was suspended by the previous Acting Municipal Manager from April 2008 to September 2008 after he exposed the irregularities by the Acting Municipal Manager which also resulted in internal controls to collapse. The municipal council did not have a functioning oversight due to political instability in the municipal council.

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
RA = Risk assessment	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1

The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which in turn are not linked to an effective reward system.	7
IC = Information and communication	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
M = Monitoring	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self-assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

Key governance responsibilities

30. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
Clear trail of supporting documentation that is easily available and provided in a timely manner			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.	X	
Quality of financial statements and related management information			
2.	The financial statements were not subject to any material amendments resulting from the audit.		X
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.	X	
Timeliness of financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines in section 126 of the MFMA.		X
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.	X	
Development of and compliance with risk management, effective internal control and governance practices			
6.	Audit committee		
	• The municipality had an audit committee in operation throughout the financial year.		X
	• The audit committee operates in accordance with approved, written terms of reference.		X
	• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		X
7.	Internal audit		
	• The municipality had an internal audit function in operation throughout the financial year.		X
	• The internal audit function operates in terms of an approved internal audit plan.		X
	• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		X
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk		X

No.	Matter	Y	N
	management.		
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		X
10.	The information systems were appropriate to facilitate the preparation of the financial statements.	X	
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(1)(c)(i) of the MFMA.		X
12.	Powers and duties have been assigned as set out in section 79 of the MFMA.	X	
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.	X	
14.	SCOPA resolutions have been substantially implemented.	X	
Issues relating to the reporting of performance information			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		X
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		X
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the Xhariep District Municipality against its mandate, predetermined objectives, outputs, indicators and targets in accordance with section 68 of the MFMA.		X
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		X

Include overall reflections on the governance framework based on other key governance requirements

31. The financial statement were subject to material amendments resulting from audit because the municipality engaged the consultants in preparing the financial statements and the underlying accounting records of the municipality did not facilitate the preparation of the financial statements to comply with the accounting framework.

32. Although the accounting officer prioritised the appointment of the audit committee members and filling the position in the internal audit unit, challenges were experienced in attracting suitable candidates with relevant skills and expertise.
33. The position of the risk officer was vacant during the period under review which resulted in risk assessment and monitoring of compliance with laws and regulations not being conducted due to challenges of attracting suitable candidates and non existence of the internal audit unit.

Investigations

34. An investigation is being conducted to investigate the 2003/2004 audit report of the Auditor General. The investigation was completed but the report was still not available at the reporting date.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

35. I was engaged to review the performance information.

The accounting officer's responsibility for the performance information

36. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

The Auditor-General's responsibility

37. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
38. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
39. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the review findings reported below.

Findings on performance information

Non-compliance with regulatory requirements

No reporting of performance information

40. The annual report of the Xhariep District Municipality did not include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the MSA, as required by section 121(3)(c) of the MFMA. Key performance indicators were not identified in the IDP due to lack of funding, consequently there were not projects undertaken by the municipality during the period under review.

No integrated development plan or service delivery

41. The Xhariep District municipal council did not, within the prescribed period after the start of its elected term, adopt a single, inclusive and strategic plan for the development of the municipality, as required by section 25 of the MSA.
42. The Xhariep District municipal council did not, within the prescribed period after the start of its elected term, adopt a process set out in writing to guide the planning, drafting, adoption and review of its integrated development plan, as required in terms of section 28 of the MSA.

Lack of adoption or implementation of a performance management system

43. The Xhariep District Municipality did not implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

No mid-year budget and performance assessments

44. The accounting officer of the Xhariep District Municipality did not by 25 January 2009 assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72 of the MFMA. The review findings mainly resulted from the council which was not sitting due to political and leadership instability.

APPRECIATION

45. The assistance rendered by the staff of the Xhariep District Municipality during the audit is sincerely appreciated.

Auditor-General
Bloemfontein

3 December 2009



Auditing to build public confidence